

Internal Revenue Service

Department of the Treasury
Washington, DC 20224

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Third Party Communication: None
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Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
CC:PSI:B01
PLR-105525-09
Date:
August 10, 2009

Legend:

X =

State =

D1 =

D2 =

D3 =

Year1 =

Year2 =

Year3 =

Year4 =

Year5 =

a =

n =

Dear _____ :

This responds to the letter dated February 6, 2009, and subsequent correspondence, submitted on behalf of X, requesting relief under § 1362(f) of the Internal Revenue Code.

Facts

The information submitted states that X was incorporated under the laws of State on D1. X elected to be treated as an S corporation effective D2. At the beginning of Year1, X had \$a of accumulated earnings and profits due to its prior C corporation years. For each of the consecutive years of Year1, Year2, and Year3, X had passive investment income exceeding 25 percent of its yearly gross receipts. Therefore, X's S election terminated on D3.

In Year 4, X discovered the termination of its S election as of D3 and distributed all of its subchapter C earnings and profits to its shareholders. X and its shareholders agree to make any adjustments consistent with the treatment of X as an S corporation as may be required by the Secretary.

Law and Analysis

Section 1361(a)(1) defines an "S corporation" as a small business corporation for which an election under § 1362(a) is in effect for the taxable year.

Section 1362(d)(3)(A)(i) provides that an election under § 1362(a) shall be terminated whenever the corporation has accumulated earnings and profits at the close of each of 3 consecutive taxable years, and has gross receipts for each of such taxable years more than 25 percent of which are passive investment income.

Section 1362(d)(3)(A)(ii) provides that any termination under § 1362(d)(3) shall be effective on and after the first day of the first taxable year beginning after the third consecutive taxable year referred to in § 1362(d)(3)(A)(i).

Section 1362(d)(3)(C)(i) provides that except as otherwise provided, the term "passive investment income" means gross receipts derived from royalties, rents, dividends, interest, annuities, and sales or exchanges of stock or securities.

Section 1362(f) provides in part that if (1) an election under § 1362(a) by any corporation was terminated under § 1362(d), (2) the Secretary determines that the circumstances resulting in the termination were inadvertent, (3) no later than a reasonable period of time after the discovery of the circumstances resulting in the termination, steps were taken so that the corporation for which the termination occurred

is a small business corporation, and (4) the corporation for which the termination occurred, and each person who was a shareholder in such corporation at any time during the period of inadvertent termination of the S election, agrees to make such adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary with respect to such period, then, notwithstanding the circumstances resulting in the termination, the corporation is treated as an S corporation during the period specified by the Secretary.

Section 1375 imposes a tax on the income of an S corporation that has accumulated earnings and profits at the close of a taxable year, and that has gross receipts more than 25 percent of which are passive investment income (within the meaning of § 1362(d)(3)).

Conclusion

Based solely upon the representations made and the information submitted, we conclude that X's S election terminated on D3, because X had subchapter C earnings and profits at the close of each of the three consecutive years, Year1, Year2, and Year3, and had gross receipts for each of those years of which more than 25 percent was passive investment income.

We further conclude that the termination of X's S election on D3 was an inadvertent termination within the meaning of § 1362(f). Pursuant to the provisions of § 1362(f), X will be treated as continuing to be an S corporation on D3 and thereafter, unless X's S election is otherwise terminated under § 1362(d), and provided that the following conditions are met.

As an adjustment under § 1362(f)(4), X must send a payment of \$n with a copy of this letter to the following address:

Internal Revenue Service
Cincinnati Service Center
Stop 31 Manual Deposit
201 West Rivercenter Blvd.
Covington, KY 41019

X must send this payment no later than 60 days from the date of this letter.

No amendments shall be made to the Year5 income tax returns of X and its shareholders with respect to the issues addressed in this letter.

If all of the above conditions are not met, then this ruling is null and void. Furthermore, if these conditions are not met, X must notify Cincinnati Service Center that its S election has terminated.

Except as expressly provided herein, no opinion is expressed or implied as to the federal tax consequences of the facts described above under any other provision of the Code. In particular, no opinion is expressed as to whether X is an S corporation for federal tax purposes.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Pursuant to the power of attorney on file with this office, a copy of this letter will be sent to X's authorized representative.

Sincerely,

David R. Haglund

David R. Haglund
Senior Technician Reviewer, Branch 1
Office of Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures (2):

Copy of this letter,
Copy for § 6110 purposes

cc: